

OFFICES OF THE
STATE AUDITOR OF MISSOURI
JEFFERSON CITY

STATE LOTTERY COMMISSION
TWO YEARS ENDED JUNE 30, 1998

MARGARET KELLY, CPA



Report No. 99-05
January 5, 1999

STATE LOTTERY COMMISSION

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STATE AUDITOR'S REPORT



STATE AUDITOR OF MISSOURI
JEFFERSON CITY, MISSOURI 65102

MARGARET KELLY, CPA
STATE AUDITOR

P.O. Box 869
(573) 751-4824

Honorable Mel Carnahan, Governor
and
State Lottery Commission
and
James R. Scroggins, Executive Director
State Lottery Commission
Jefferson City, Missouri 65102

The State Auditor is required under Section 313.315(l), RSMo 1994, to audit the accounts and transactions of the State Lottery Commission. The commission had engaged Arthur Anderson and Company, Certified Public Accountants (CPA), to perform annual audits of the State Lottery Commission for the years ended June 30, 1998 and 1997. To satisfy our statutory obligation and minimize duplication of effort, the State Auditor has used the work of the CPAs. We reviewed the reports and substantiating working papers of the CPAs to satisfy ourselves as to the appropriateness of using their reports, and we accept them in partial fulfillment of our responsibility under Section 313.315(1), RSMo 1994.

The additional objectives of this review were to:

1. Examine compliance with certain constitutional provisions, statutes, administrative rules, and attorney general's opinions as we deemed necessary or appropriate in the circumstances.
2. Examine certain management practices which we believe could be improved.
3. Follow-up on the status of recommendations made in our previous report.

Our review was made in accordance with applicable generally accepted government auditing standards and included such procedures as we considered necessary in the circumstances. In this regard, we interviewed agency personnel, observed selected activities, and reviewed certain records and documents.

As part of our review, we assessed the agency's management controls to the extent we determined necessary to evaluate the specific matters described above and not to provide assurance

on those controls. With respect to management's controls, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation and we assessed control risk.

Our review was limited to the specific matters described above and was based on selected tests and procedures considered appropriate in the circumstances. Had we performed additional procedures, other information might have come to our attention that would have been included in this report.

The accompanying History, Organization, and Statistical Information is presented for informational purposes. This information was obtained from the agency's management and was not subjected to the procedures applied in our review of the State Lottery Commission.

Our comments on internal controls, compliance with legal requirements, management practices, and related areas are presented in the accompanying Management Advisory Report.


Margaret Kelly, CPA
State Auditor

December 10, 1998

MANAGEMENT ADVISORY REPORT SECTION

Management Advisory Report -
State Auditor's Current Recommendations

STATE LOTTERY COMMISSION
MANAGEMENT ADVISORY REPORT-
STATE AUDITOR'S CURRENT RECOMMENDATIONS

In addition to our review of the report and substantiating working papers of Arthur Andersen and Company, Certified Public Accountants, we included those procedures which we considered necessary in the circumstances.

We reviewed probable compliance with certain constitutional provisions, statutes, administrative rules, and attorney general's opinions as we deemed necessary or appropriate. This review was not intended to provide assurance of full compliance with all regulatory provisions and, thus, did not include all regulatory provisions which may apply. Our review disclosed no conditions that may represent noncompliance.

The period of audit for the purposes stated above included, but was not necessarily limited to, the two years ended June 30, 1998.

This report is intended for the information of the agency's management and other applicable government officials. However, this report is a matter of public record and its distribution is not limited.

Follow-Up on State Auditor's Prior Recommendations

STATE LOTTERY COMMISSION
FOLLOW-UP ON STATE AUDITOR'S PRIOR RECOMMENDATIONS

This section reports follow-up action taken by the State Lottery Commission (SLC) on recommendations made in the Management Advisory Report (MAR) of our report issued for the three years ended June 30, 1996.

1. Advertising

- A. The SLC paid the advertising agency \$79,037 for routine business expenses even though the contract with the advertising agency stated these costs were not to be charged to the SLC.
- B. During the three years ended June 30, 1996, the SLC paid approximately \$258,000 to the advertising agency for sales taxes.
- C. Although the SLC spent a significant amount of money each year on advertising, it had not had an independent review of the effectiveness of its advertising.

Recommendation:

The SLC:

- A. Strictly enforce the contract terms in the current contract with the advertising agency and discontinue the practice of reimbursing the advertising agency for routine business matters.
- B. Work with the advertising agency to minimize the amount of sales tax paid.
- C. Have an independent reviewer conduct a study of the effectiveness of advertising on sales of lottery products.

Status:

- A. Implemented. The SLC sent a letter to the advertising agency emphasizing the terms of the contract and more closely monitored the advertising agency for compliance with the contract. However, we did note several payments to the advertising agency we consider to be for routine business matters. The SLC has contracted with a new advertising agency and clarified the issue of routine business matters in the new contract and is monitoring the new advertising agency for compliance with the contract.
- B. Implemented. The SLC made a greater effort not to purchase prizes through the advertising agency.

- C. Implemented. The SLC contracted with a university to perform a study of the effectiveness of advertising.

2. Sponsorships

The SLC spent \$200,000 to \$300,000 each year sponsoring events of civic organizations.

Recommendation:

The SLC review the propriety of these payments.

Status:

Implemented. After each of these events, the SLC now prepares a report of the benefits received by the SLC as a result of sponsoring the event.

3. Fun and Fortune Game Show

- A. The SLC spent approximately \$4.7 million annually on the Fun and Fortune game show and should closely monitor the progress of the game and the benefits received.
- B. Prize checks for the game show were not always reviewed by an independent reviewer to verify the checks were for the correct amount.
- C. The SLC did not follow its security policy of not allowing anyone to leave the secure room once the actual game was generated ensuring the security of the computer room during the game show.

Recommendation:

The SLC:

- A. Closely monitor the progress of the game show and ensure the benefits received are obtained in a cost effective manner.
- B. Have another employee or the independent auditor monitor the prizes won by each contestant and verify the amounts of the prize checks before the checks are distributed. Appropriate documentation of the verification should also be maintained.
- C. Enforce its security policy at the game show and not allow anyone to leave the secure room once the game has been generated on the computer, or consider other alternatives to ensure the security of the game is not compromised.

Status:

- A. Implemented. The SLC conducted several in-house studies of the cost-effectiveness of the game show.
- B. Implemented.
- C. Implemented.

STATISTICAL SECTION

History, Organization, and
Statistical Information

STATE LOTTERY COMMISSION
HISTORY, ORGANIZATION
AND STATISTICAL INFORMATION

The State Lottery Commission was created June 11, 1985, by Senate Bill No. 44, First Regular Session, 83rd General Assembly. That action followed voter approval of a lottery amendment to the Missouri Constitution at the November 1984 general election. The State Lottery Commission began selling instant game tickets on January 20, 1986.

Section 313.321, RSMo 1994, provides that money received from the sale of lottery tickets shall be divided as follows: A minimum of 45 percent shall be awarded as prizes; administration, advertising, promotion, and retailer compensation costs shall be paid as appropriated by the General Assembly; and the remainder shall be transferred to the General Revenue Fund. Effective July 1, 1993, Article III, Section 39(b) of the Missouri Constitution requires the remainder to be transferred to the Lottery Proceeds Fund (instead of the General Revenue Fund) to be appropriated solely for institutions of elementary, secondary, and higher education.

A five-member lottery commission is appointed by the governor with the advice and consent of the Senate. The commission must meet at least quarterly. The commission has the authority to promulgate rules as it deems necessary and desirable to fully implement the lottery as mandated by the people in Article III of the Missouri Constitution. It appoints a director to act as secretary of the commission and keep all books and records of the commission. The director of the lottery oversees the commission's operation and administration. At June 30, 1998, James R. Scroggins served as the Executive Director. At June 30, 1998, the members of the commission were as follows:

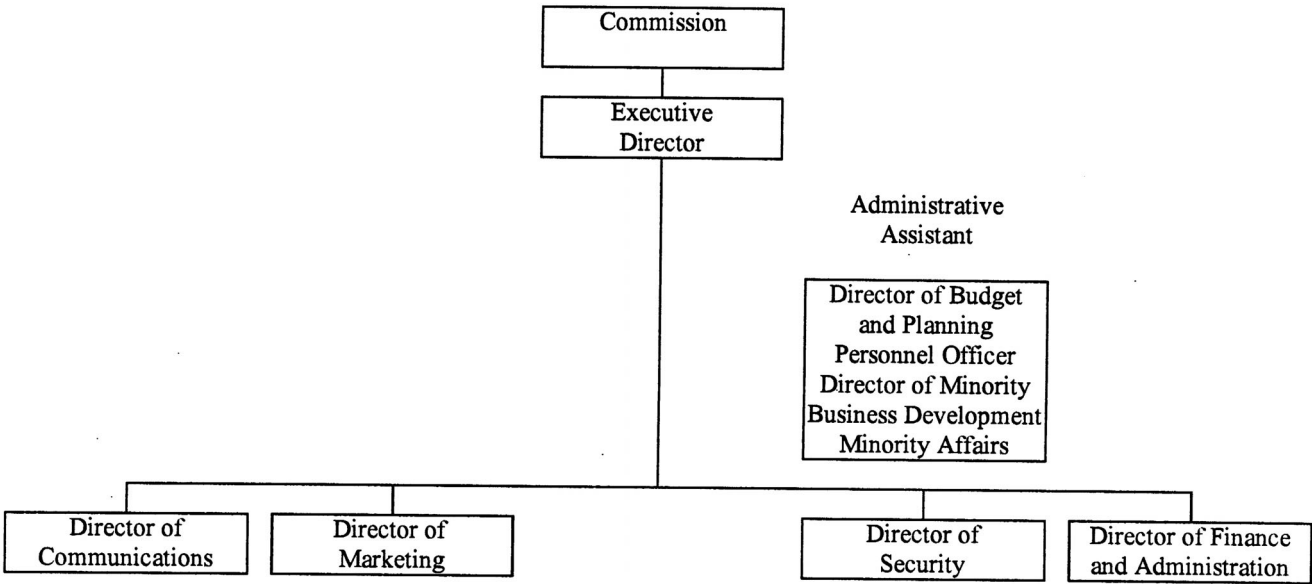
| <u>Commissioner</u> | <u>Term Expires</u> |
|----------------------------|---------------------|
| William E. James, Chairman | September 7, 1998 |
| Kenneth R. Hensley | September 9, 1998 |
| Robert J. Mayfield | September 7, 1997* |
| Jana L. Poteet | September 7, 1996* |

* Commissioners continue to serve until a replacement is named.

No appointments have been made to the vacant positions on the commission.

The State Lottery Commission staff is organized into four divisions. Each division is headed by a director who coordinates activities to meet the commission's objectives. At June 30, 1998, the State Lottery Commission employed approximately 171 individuals. An organization chart follows.

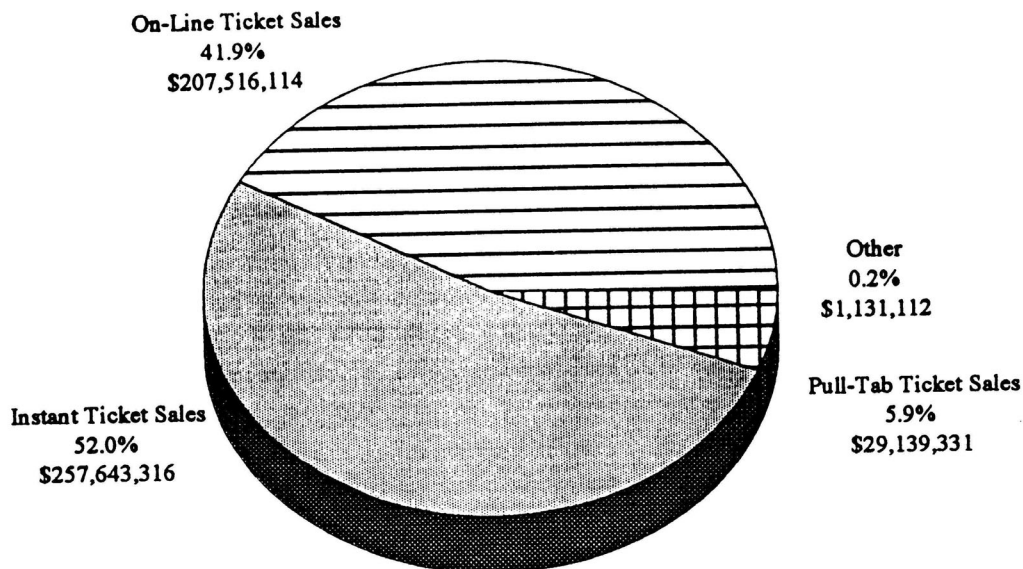
STATE LOTTERY COMMISSION
ORGANIZATION CHART
JUNE 30, 1998



Appendix A

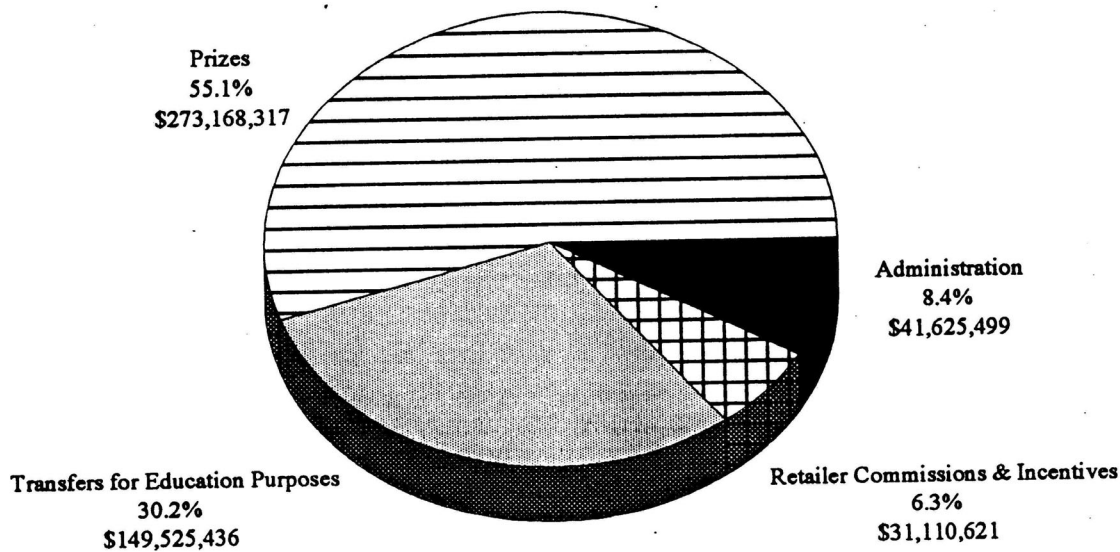
STATE LOTTERY COMMISSION
REVENUE AND EXPENDITURE CHARTS
YEAR ENDED JUNE 30, 1998

Revenues



Total Revenues: \$495,429,873

Expenditures

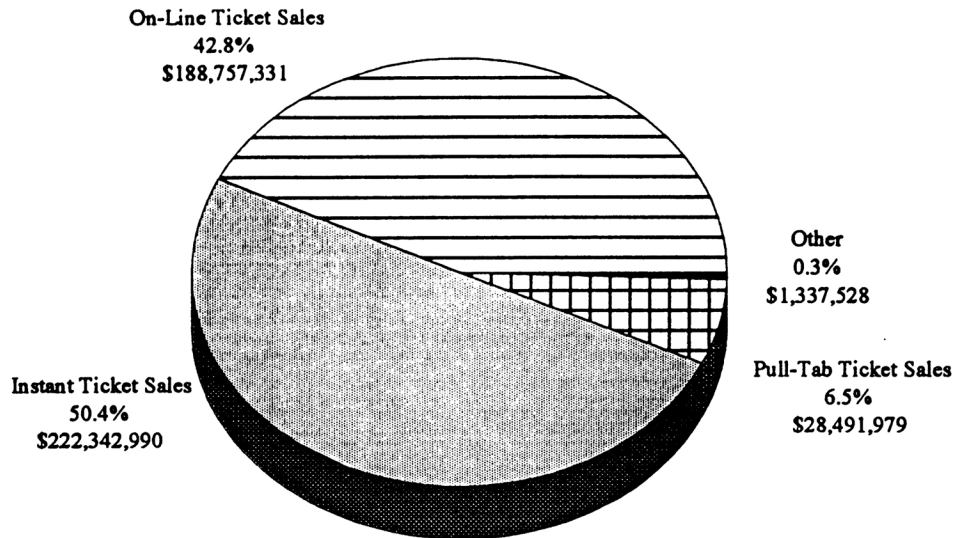


Total Expenditures: \$495,429,873

Appendix B

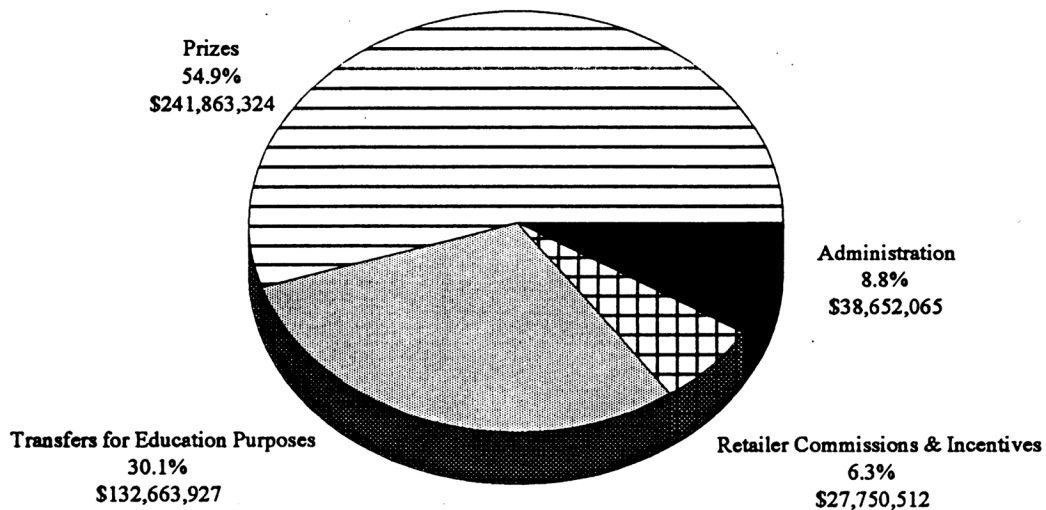
**STATE LOTTERY COMMISSION
REVENUE AND EXPENDITURE CHARTS
YEAR ENDED JUNE 30, 1997**

Revenues



Total Revenues: \$440,929,828

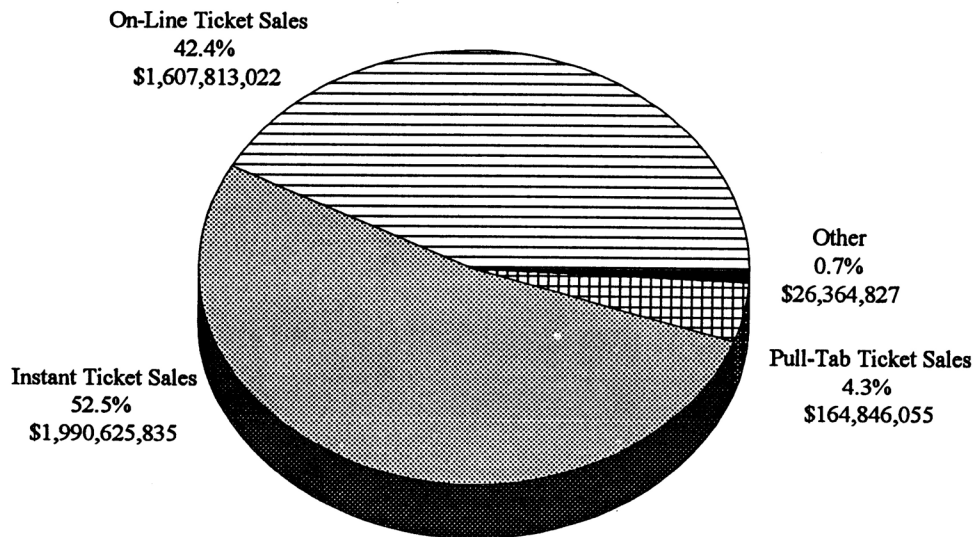
Expenditures



Total Expenditures: \$440,929,828

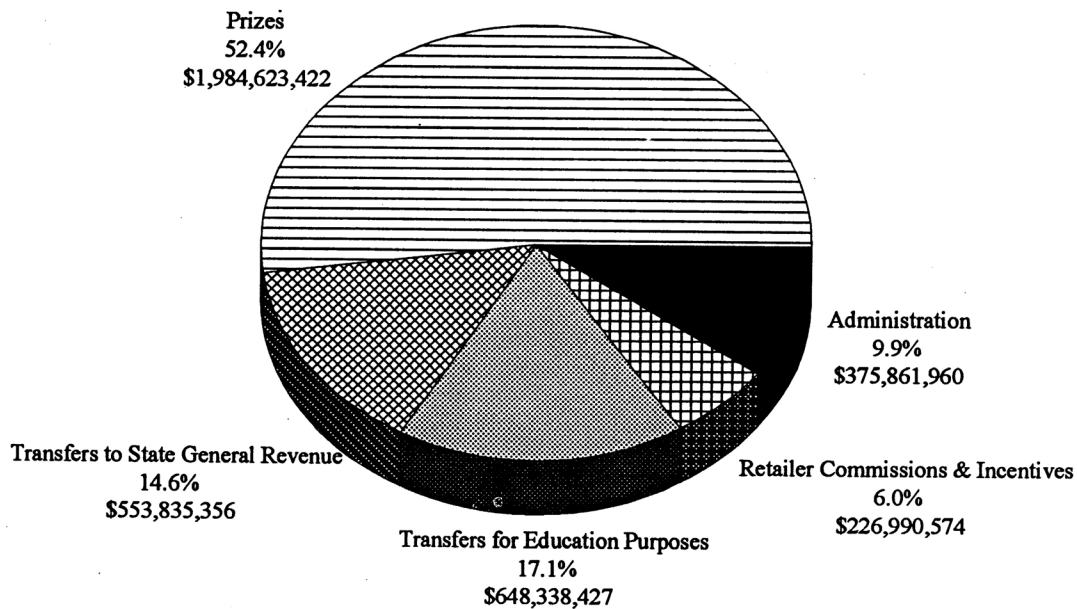
STATE LOTTERY COMMISSION
REVENUE AND EXPENDITURE CHARTS
JANUARY 20, 1986 THROUGH JUNE 30, 1998

Revenues



Total Revenues: \$3,789,649,739

Expenditures



Total Expenditures: \$3,789,649,739

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